No. 83-211

In The

Supreme Court of the United States

October Term, 1983

LUCILE LOWRY and LOWRY-ZWEIG CORP.,
Petitioners

v.

THE BALTIMORE and OHIO RAILROAD COMPANY, THE CHESAPEAKE and OHIO RAILWAY COMPANY and CHESSIE SYSTEM, INC.,
Respondents

RESPONSE TO PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

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QUESTIONS PRESENTED

I. Does the defendants' good faith reliance on the advice of counsel preclude a finding of the scienter necessary to establish a violation of Section 10(b) of the Securities Exchange Act of 1934 and SEC Rule 10b-5?

II. Does SEC Rule 10b-17 contravene the decision of this Court in *Ernst & Ernst v. Hochfelder* requiring scienter as a necessary element of a Rule 10b-5 violation?

III. Where five members of the eight judge en banc Court of Appeals, employing two separate legal rationales, vote to affirm the judgment of the District Court, is not affirmance of that judgment proper?

IV. Are claims under section 10(b) automatically assigned to a subsequent purchaser of a security?

LISTING UNDER SUPREME COURT RULE 28.1

The CSX Corporation owns 100% of The Chesapeake and Ohio Railway Company.

The Baltimore and Ohio Railroad Company has the following subsidiaries and affiliates which come within Rule 28.1:

a. The Baltimore and Philadelphia Railroad Company;

b. Cleveland Terminal & Valley Railroad Company;

c. Dayton and Michigan Railroad Company;

d. Dayton and Union Railroad Company.

The Chesapeake and Ohio Railway Company has the following subsidiaries and affiliates which come within Rule 28.1:

a. Chicago South Shore & South Bend Railroad;

b. Richmond-Washington Company;

c. Richmond, Fredericksburg & Potomac Railroad Company; and

d. Richmond Land Company.

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STATEMENT OF THE CASE

A. Procedural History

This action arises out of a dividend which was declared by the Board of Directors of The Baltimore and Ohio Railroad Company ("B&O") on December 13, 1977 payable to shareholders of record of B&O Common Stock on that date. The dividend was in the stock of a wholly-owned subsidiary of the B&O, Mid-Allegheny Corp. ("MAC"). The petitioners are holders of B&O Convertible 4½% Debentures ("the Debentures")[1] which they purchased *after* December 13, 1977 and with full knowledge of all of the circumstances surrounding the declaration of the dividend.

On October 22, 1979, petitioners filed a class action suit in the United States District Court for the Western District of Pennsylvania against the B&O, The Chesapeake and Ohio Railway Company ("C&O") and Chessie System, Inc. ("Chessie") alleging that the manner of the declaration of the MAC dividend, *inter alia*, violated Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b) and Rule 10b-5, 17 C.F.R. § 240.10b-5, because Debentureholders had not received advance notice of the declaration of the MAC dividend.

At the time petitioners brought suit, there were two related private suits pending in the Western District, *Pittsburgh Terminal Corp. v. The Baltimore & Ohio R.R. Co.* and *Monroe Guttmann v. The Baltimore & Ohio R.R. Co.* (collectively referred to as the "*Pittsburgh Terminal*" case). Those actions were brought by Debentureholders who had owned their Debentures on December

1. Each of the Debentures has a face value of $1,000 and is convertible into ten shares of B&O Common Stock at any time before maturity in the year 2010.

13, 1977, the date of the MAC dividend, and also alleged violations of Section 10(b) and Rule 10b-5. The *Pittsburgh Terminal* case went to trial on July 21-24, 1980 before the District Court sitting without a jury. The trial court on March 10, 1981 entered judgment in favor of all defendants and dismissed the complaints finding, *inter alia*, the plaintiffs had failed to prove that the defendants possessed the requisite scienter to establish a violation of Section 10(b) and Rule 10b-5.

Following the dismissal of the *Pittsburgh Terminal* action, the Defendants moved for summary judgment in the *Lowry* case solely on the basis of the District Court's decision in *Pittsburgh Terminal* (Supplemental Appendix 1b). Counsel for the *Lowry* plaintiffs submitted a letter to the Court (Supplemental Appendix 5b) in which he requested that this matter be decided, as stated by the District Court, "on the basis of the decision in the *Guttman* cases without receiving any further evidence considering all the papers in the cases as submitted for determining defendant's motion for summary judgment". (63a) The *Lowry* plaintiffs "asserted that by entering judgment now, this matter could be presented to the circuit at the same time as the other cases". (62a). The District Court stated that "[u]nder the circumstances, the court is willing to comply" (63a) and entered summary judgment in favor of the defendants (60a).

The plaintiffs in *Pittsburgh Terminal* and *Lowry* both filed appeals with the United States Court of Appeals for the Third Circuit ("Third Circuit") and the cases were consolidated for appeal purposes. Argument was heard before a panel of the Third Circuit on December 17, 1981 in *Pittsburgh Terminal* and *Lowry*. On June 3, 1982, without explanation, the Third Circuit issued its decision in the *Pittsburgh Terminal* case only, reversing

the District Court's decision and remanding for a determination of the appropriate relief. *Pittsburgh Terminal Corp. v. Baltimore & Ohio R.R. Co.*, 680 F.2d 933 (3d Cir.), *cert. denied*, 103 S.Ct. 476 (1982). The panel's decision (two judges concurring, one dissenting) rested solely on a finding that the defendants had failed to give ten days advance notice of the MAC dividend in accordance with SEC Rule 10b-17, 17 C.F.R. § 240.10b-17 (1981). Subsequently, on June 22, 1982, the Third Circuit *sua sponte ordered argument en banc* in *Lowry* only, again without explanation. Thus, these two cases, which had been joined together for appeal purposes and which were mutually dependent upon each other, became unconnected through no fault of the defendants.

Defendants petitioned this Court for a writ of certiorari in the *Pittsburgh Terminal* case on October 6, 1982. No. 82-622, October Term, 1982. Meanwhile, reargument *en banc* was held before the Third Circuit on November 8, 1982 in the *Lowry* case. On November 29, 1982, this Court denied certiorari in the *Pittsburgh Terminal case.* It was not until May 10, 1983, however, that the Third Circuit issued its decision in *Lowry.*

In its *per curiam* opinion and judgment, the *en banc* Third Circuit dismissed all of the *Lowry* plaintiffs' claims under the federal securities laws. (Supplemental Appendix 4b). The basis for the judgment was that three judges (Adams, Garth and Sloviter, C.J.J.) did not believe that causes of action under Rule 10b-5 are automatically assignable to subsequent purchasers (*i.e.*, the *Lowrys*) of the Debentures; and that two of the judges, (Aldisert and Hunter, C.J.J.) did not believe that Rule 10b-5 was in any way violated. While dismissing the *Lowry* plaintiffs' federal claims by a vote of 5-3, the Third Circuit unanimously remanded the state claims (those under the In-

denture, New York Stock Exchange Rules and other common law claims for breach of fiduciary duty) to the District Court.

As noted above, the decision of the Third Circuit in *Pittsburgh Terminal* rests entirely upon a finding by the panel that the defendants had failed to comply with Rule 10b-17 (an issue raised for the first time on appeal by the SEC in its *amicus* brief in *Pittsburgh Terminal* and not raised at all in *Lowry*). It is the defendants' contention that this holding was erroneous and that the fact that the defendants did not violate Rule 10b-5 provides yet another ground for the affirmance of the *Lowry* judgment (as found by two judges of the *Lowry en banc* Court).[2]

B. Factual Background

The declaration of the dividend of MAC shares was an essential part of a corporate reorganization of Chessie that began in 1973. This reorganization was designed to segregate in a separate corporation the assets of the C&O, wholly-owned by Chessie, and its subsidiaries, in-

2. Petitioners suggest that collateral estoppel bars this contention because of the denial of certiorari by this Court in *Pittsburgh Terminal*. The law is well-settled, however, that the denial of certiorari does not constitute an adjudication on the merits, *Hughes Tool Co. v. TWA*, 409 U.S. 363, 365 n. 1 (1973), and that this Court may look back and correct any errors that may have occurred during any stage of the proceedings. *Mercer v. Theriot*, 377 U.S. 152 (1964). Furthermore, it would indeed be anomalous if the defendants were collaterally estopped in this case where, through no fault of their own, these related matters, once consolidated on appeal, were decided separately, contrary to the counsel of this Court. *See Reed v. Allen*, 286 U.S. 191, 198 (1932).

cluding the B&O, which were not essential for rail operations. In order to effectuate the transfer of the B&O non-rail assets, it was decided by a Corporate Restructuring Committee within Chessie that those assets should be transferred to MAC, a wholly-owned subsidiary of the B&O. The B&O, in turn, would declare a dividend-in-kind in the shares of MAC on its common stock.[3] The C&O would then declare a dividend of the MAC shares it received to its sole shareholder, Chessie. Chessie would then contribute its MAC shares to a development company called Chessie Resources, Inc., where the nonrail properties could be developed free of restrictions imposed by the Interstate Commerce Commission on railroads. No challenge has ever been made to this manner of proceeding by any of the plaintiffs in these cases.

The only challenge, and the only basis for plaintiffs' claims under Rule 10b-5, has been to the decision of the B&O to make the declaration, record and payment dates of the MAC dividend the same. Recommendation for that course of action was made by counsel for the B&O, Robert F. Hochwarth ("Hochwarth") in order that the MAC dividend would be eligible for a "no action" letter from the SEC[4]. The B&O desired such a no action letter

3. In December, 1977, 99.63% of the common stock of the B&O was under the control of the C&O. The remaining shares were held by thirteen minority shareholders who would also receive the MAC dividend, thus retaining their proportionate interest in all of the properties of the B&O.

4. This procedure was found to be in accord with the law governing dividends by a Maryland corporation such as the B&O. Maryland Corporations and Associations, §2-511.

in order to avoid the necessity of filing a registration statement with the SEC.[5]

In connection with this recommendation, Hochwarth consulted with attorneys from an outside law firm, that had been retained because of its expertise in securities law. In November, 1977, prior to the MAC dividend, Hochwarth outlined to a senior partner at the law firm, the proposal to make the date of record, declaration and payment the same, and asked him to "[p]lease let me know if you see any problems with this procedure". No attorney at the firm ever raised any objection to that proposal. Furthermore, the firm prepared the request for a no action letter which was submitted to THE SEC.

Hochwarth and Roland Donnem ("Donnem"), Vice President, Law for the B&O, considered whether there was an obligation for the B&O to give ten (10) days advance notice of the MAC dividend to the New York Stock Exchange ("NYSE"). A requirement to give notice of certain dividends was contained in the listing agreement for the B&O common stock, which was incorporated by reference in the listing agreement for the Debentures. Hochwarth and Donnem, however, concluded that the ten day advance notice requirement did not apply to the MAC dividend because it was applicable only to dividends declared on stocks listed on the NYSE and the B&O common stock had neither been listed nor traded for at least two years prior to the declaration of the MAC dividend.

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5. On September 7, 1979, after it had long been aware of the *Pittsburgh Terminal* lawsuit, the SEC issued the requested no action letter.

While neither Hochwarth nor Donnem specifically considered whether notice had to be given pursuant to Rule 10b-17, the Third Circuit's predicate for liability in the *Pittsburgh Terminal* case, the notice required by that Rule is met if "[g]iven in accordance with procedures of the national securities exchange or exchanges upon which a security of such issues is registered . . . which contain requirements substantially comparable to those set forth in paragraph (bxl) of this section". § 240.10b-17(b)(2).

ARGUMENT

I. Defendants Are Not Liable Under Rule 10b-5

A. Defendants Good Faith Reliance on the Advice of Counsel Precludes a Finding of Scienter

Petitioners in their Petition for Certiorari do not directly address the question of defendants' liability under Rule 10b-5. Defendants believe, however, that the fact that the defendants did not violate the securities' laws provides yet another ground for the affirmance of the Third Circuit's decision. Since all of the judges on the *en banc* court discussed the issue, defendants believe that it forms a proper ground for review in this Court. Because defendants believe that the panel's holding in *Pittsburgh Terminal* was wrongly decided, it is hoped that this Court will grant review of this matter to affirm that there has been no violation of the securities laws by the defendants.[6]

The finding of the Third Circuit in *Pittsburgh Terminal* is that "[a] violation of Section 10(b) does not require a specific intention to break the law. It requires only knowing or intentional actions which, objectively examined amount to a violation". 680 F.2d at 942. This holding has been roundly criticized. Francis M. Wheat, former commissioner of the SEC and distinguished securities lawyer, has stated that the Third Circuit in *Pittsburgh Terminal* announced "a standard for 'scienter' which takes the guts out of the *Hochfelder* doctrine". Speech of Francis M. Wheat to Regional Se-

6. On the other hand, for the reasons stated *infra*, defendants will demonstrate that the issues advanced by petitioners do not merit this Court's review.

curities and Exchange Commission Seminar, Los Angeles, Calif. (October, 1982).

On the other hand, the SEC has interpreted the Third Circuit's holding as a weakening of the scienter standard because under the Third Circuit's decision scienter may be found in spite of the good faith reliance on the advice of counsel. Remarks of Jacob Stillman, Associate General Counsel, Securities and Exchange Commission, SEC Speaks (March 5, 1983). It thus appears that the argument which the SEC lost in *Ernst & Ernst v Hochfelder*, 425 U.S. 185, 198 (1976) has been won in *Pittsburgh Terminal* and perpetuated in *Lowry* unless this Court should act to reaffirm its guiding principles regarding scienter and liability under Rule 10b-5.

Since the Court denied certiorari in *Pittsburgh Terminal*, this Court decided the case of *Dirks v. Securities and Exchange Commission*, 51 U.S.L.W. 5123 (June 28, 1983) in which this Court affirmed many of those same principles abandoned by the Third Circuit in *Pittsburgh Terminal*. In ascertaining whether the defendant in that case was an "insider" subject to the restrictions on insider trading under Rule 10b-5, the Court reemphasized that "[n]ot 'all breaches of fiduciary duty in connection with a securities transaction', however, come within the ambit of Rule 10b-5. *Santa Fe Industries, Inc. v. Green*, 430 U.S. 462, 472 (1977). There must also be 'manipulation or deception'. *Id.* at 473" 51 U.S.L.W. at 5125.

Furthermore, the Court went on to specifically discuss the type of scienter necessary to meet that requirement of "manipulation or deception":

> "*Scienter*—'a mental state embracing intent to deceive, manipulate or defraud', *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 193 n.12 (1976)—is an independent element of a Rule 10b-5 violation. See *Aaron*

> *v. SEC*, 446 U.S. 680, 695 (1980). Contrary to the dissent's suggestion, see *post*, at p. 7, n.10, motivation is not irrelevant to the issue of *scienter*. It is not enough that an insider's conduct results in harm to investors; rather a violation may be found only where there is 'intentional or willful conduct designed to deceive or defraud investors by controlling or artificially affecting the price of securities' ".

51 U.S.L.W. at 5127 n.23.

Although as noted, the dissenting justices in *Dirks* questioned whether motive was relevant to the requirement of scienter, those justices also acknowledged that the "scienter requirement functions in part to protect good faith errors". 51 U.S.L.W. at 5131 n.12.

In the present case, even assuming the applicability of Rule 10b-17 to the MAC dividend[7], the undisputed facts are that the lawyers for the B&O specifically considered whether notice had to be given to the Debentureholders under the NYSE listing agreement, the functional equivalent of Rule 10b-17. See pp. 6-7, *supra*. They concluded that such notice did not have to be given. As Commissioner Bevis Longstreth of the Securities Ex-

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7. Judge Adams, dissenting from the panel's holding in *Pittsburgh Terminal* made a strong argument that the panel's holding misreads Rule 10b-17 in that it was not designed to provide any substantive rights to investors, only protect those which they already had. 680 F.2d at 953. Since the Debentureholders had no right to advance notice under the Indenture under which the Debentures were issued, Rule 10b-17 cannot supply such a requirement. 680 F.2d at 954. *Cf. Broad v. Rockwell International Corp.*, 642 F.2d 929 (5th Cir.) (en banc), *cert. denied*, __ U.S. __, 70 L.Ed2d 380 (1981).

change Commission has said in discussing the facts of this case: "If counsel is wrong as to the duty, an action based upon the contract will lie, regardless of counsel's advice and the defendant's good faith reliance on it. But to charge scienter under these circumstances, thereby affording a basis for an action under 10b-5, seems misplaced." Longstreth, *Reliance on Advice of Counsel as a Defense to Securities Law Violations*, 37 Bus. Law, 1185, 1196 (1982).

Commenting on Commissioner Longstreth's speech and the facts of this case, the leading commentators on the advice of counsel defense have also stated that "if legal advice concerning the duty to provide notice was an important element in the defendants' decision not to give notice, the fact that they knew what they were doing and knew the consequences of their actions does not amount to scienter because, based on that advice, they neither intended to, nor did they, act with deception". Hawes & Sherrard, "Speech May Suggest 'Advice of Counsel' Evolution", *Legal Times*, March 1, 1982, at 11, Col. 1.

The decision of the Third Circuit in *Pittsburgh Terminal* represents a step backward in the recognition that good faith reliance on the advice of counsel can negate the element of scienter. Cf. *Shidler v. All American Life and Financial Corp.*, [1982 Transfer Binder], CCH Fed. Sec. Law ¶ 98, 875 (Sept. 30, 1982); §1703(e), ALI, Federal Securities Code, (Proposed Official Draft, 1978). This Court now has the opportunity in the *Lowry* case to once again reaffirm the principles followed so recently in the *Dirks* case and banish the aberration of *Pittsburgh Terminal.*

B. Rule 10b-17 Contravenes the Hochfelder Requirement of Scienter

Rule 10b-17 provides in relevant part:

> "It shall constitute a 'manipulative or deceptive device or contrivance' as used in section 10(b) of the Act . . . to fail to give notice in accordance with paragraph (b) of this section of the following actions . . ."

Thus, by its terms, the failure to give the required notice constitutes a violation of Section 10(b) without regard to whether scienter is present. Rule 10b-17 was adopted by the SEC in 1971, some five years before this Court's decision in *Ernst & Ernst v. Hochfelder, supra*, in which this Court held that scienter was a necessary element for a violation of Rule 10b-5. Up to the time of the Third Circuit's decision in *Pittsburgh Terminal*, there had been no case directly applying Rule 10b-17 to find a defendant liable under Section 10(b). Because Rule 10b-17 does not require scienter, it is respectfully submitted that the Rule is in direct contravention of this Court's holding in *Hochfelder*.

II. The Third Circuit Was Not Equally Divided; A Majority Was in Favor of Affirmance of the Judgment of the District Court Dismissing Plaintiff's Federal Claims

The Petitioners have contended that the Third Circuit erroneously affirmed the Judgment of the District Court dismissing the plaintiffs' claims under the securities laws. The basis for their contention is that the Third Circuit was equally divided on the issue of whether the plaintiffs as purchasers of Debentures after the date of the MAC dividend had received an automatic assignment

of the causes of action of their predecessors in interest under Rule 10b-5 and Section 10(b). While there were three judges on each side of this issue, there were in fact five judges in favor of the affirmance of the judgment of the District Court dismissing plaintiffs' claims under the securities laws and only three judges in favor of reversing that decision. Petitioners' argument is novel and without precedent in jurisprudence anywhere.

The first sentence of the *per curiam* opinion of the Court states that plaintiffs "appeal from a summary judgment dismissing their class action complaint". (2a). As stated by Judge Gibbons, that motion "was granted for the same reasons relied upon by the Trial Court in dismissing the *Pittsburgh Terminal* complaint". (35a). That is to say, the District Court dismissed the *Lowry* complaint at the request of the plaintiffs "on the basis of the decision in the *Guttman* cases without receiving any further evidence" that there had not been any violation of Rule 10b-5. (62a-63a). The dismissal of the plaintiffs' complaint by the District Court did not rest upon any determination whether the plaintiffs as subsequent Debentureholders had standing. Again, as noted by Judge Gibbons, "those issues [related to standing] are entirely apart from the grounds upon which summary judgment was entered". (36a). Yet it is from that judgment that the plaintiffs appealed.[8]

It is a fundamental rule of law that:

> "[A]ppeals have to be taken from final judgments, not from judicial rationales. And court

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8. Plaintiffs also appealed from two orders defining the class they could represent. (Supplemental Appendix 7b). Those orders are not the subject of any current controversy.

> judgments may of course be supported by any sound judicial argumentation—or by none at all if they are correct legally. Judges have at least the solace of knowing that only judicial deeds—not judicial words —may constitute legal error.

Cook v. Hirschberg, 258 F.2d 56, 57 (2d Cir. 1958). Indeed, it is axiomatic that appellate courts "review judgments, not arguments". *U.S. v. Shirey*, 359 U.S. 255, 261 n. 5 (1959). Frankfurter, J.)

Likewise, it is fundamental that "[w]here the decision below is correct it must be affirmed by the appellate court though the lower tribunal gave a wrong reason for its action". *J. E. Riley Investment Co. v. Commissioner*, 311 U.S. 55, 59 (1940).

In the present case, two of the judges agreed with the District Court's rationale in dismissing plaintiffs' complaint: there was no violation of Rule 10b-5. Three judges applied a different rationale: plaintiffs had no standing as subsequent debentureholders who did not receive an express assignment of their predecessors' causes of action. All told, however, five judges agreed with the judgment of the District Court and affirmed that judgment, albeit for two separate reasons. (see 21a, 26a).

Petitioners would have the Court believe, however, that because the Third Circuit was equally divided on the issue of automatic assignment, they should have prevailed. This ignores logic, common sense and the facts.

Petitioners contend that in reality before the Third Circuit they were seeking an affirmance of an alleged ruling of the District Court on the assignment question. This question was supposedly decided by the District Court in denying defendants' first motion for summary judgment (66a). In the first instance, of course, that or-

der was not even before the Court of Appeals since no party appealed that order. Secondly, as noted by Judge Seitz in discussing the District Court's order, "in rejecting appellees' standing argument, the District Court did not determine whether the Lowrys, and other class members who had purchased after December 13, 1977, [Lowrys] had been assigned the 10(b) claims of their sellers, nor whether they could assert those claims as assignees". (52a). The sole basis for the District Court's decision, as can be seen by even the most cursury review of its decision, is that this Court's decision in *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723 (1975) provided standing to Debentureholders without the need for a separate purchase or sale.[9] Thus, it is clear that there was nothing for the Third Circuit to affirm on the assignment issue.

Furthermore, the cases of this Court have made it clear that "[i]n cases of appeal or writ of error in this court, the appellant or plaintiff in error is always the moving party. It is affirmative action which he asks. The question presented is, shall the judgment or decree be reversed? If the judges are divided, the reversal cannot be had, for no order can be made. The judgment of the court below, therefore, stands in full force". *Durant v. Essex Co.*, 7 Wall. 107, 112 (1869). Similarly, more recently in *Neil v. Biggers*, 409 U.S. 188, 192 (1972), this

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9. Should this Court grant certiorari on any of the issues raised, it is respectfully requested that the Court also consider the applicability of *Blue Chip* to Debentureholders who neither purchase nor sell their Debentures.

Court stated that "it is the appellant or petitioner who asks the Court to overturn a lower court's decree".

It is the judgment which is appealed and not individual issues and it is the Appellant which seeks to reverse that judgment. Simply because three judges were on each side of the automatic assignment issue does not remotely imply that the Court was equally divided on the question of whether the judgment should be affirmed or reversed where a total of five judges voted in favor of affirmance of the judgment.[10]

III. There is No Authority Supporting the Automatic Assignment of Claims Under Section 10(b)

Petitioners have contended that there is a conflict between the Third Circuit and the Second Circuit on the issue of whether claims under §10(b) are automatically assigned to a subsequent purchaser of a security.[11] (Petition at p. 12). This is highly misleading. The Third Cir-

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10. *Cf. Furman v. Georgia*, 408 U.S. 238 (1972). *See also Dred Scott v. Sandford*, 19 How. (60 U.S.) 393 (1856); *Smith v. U.S.*, 5 Pet. (30 U.S.) 292, 303 (1831) for other examples where this Court has acted on the basis of a plurality of minority opinions with respect to various matters at issue. This court has held that "[w]hen a fragmented Court decides a case and no single rationale explaining the result enjoys the assent of five Justices, 'the holding of the Court may be viewed as that position taken by those Members who concurred in the judgments on the narrowest grounds . . .' *Marks v. U.S.*, 430 U.S. 188, 193 (1977).

11. The parties are in agreement that federal law is controlling in deciding this issue. See e.g. *In re Fine Paper Litigation*, 632 F.2d 1081 (3d Cir. 1980); *International ladies' Garment Workers Union v. Shields & Co.*, 209 F. Supp. 145 (S.D.N.Y. 1962).

cuit is the only Circuit which has had occasion to consider this issue. The Second Circuit case cited by Petitioners, *Phelan v. Middle States Oil Corp.*, 154 F.2d 978 (2nd Cir. 1946), was a receivership case that had nothing at all to do with either Section 10(b) or any other Federal Securities Law. It in no way can it be interpreted as establishing a rule of automatic assignability under § 10(b). The only other cases involving the assignment of claims under § 10(b) involve *express* assignments or the survivability of such claims following the death of a party. *International Ladies Garment Workers Union v. Shields*, 209 F.Supp. 145 (S.D.N.Y. 1962); *Mills v. Sarjem Corp.*, 133 F.Supp. 753 (D.N.J. 1955).

The only case other than the present that has determined the issue of the automatic assignability of such claims is *Independent Investor Protective League v. Saunders*, 64 F.R.D. 564 (E.D. Pa. 1974). In *Saunders*, the court was confronted with the very question presented by the Petitioners: do claims under Section 10(b) travel with the security? The court gave a resounding "No":

> While a security is of course transferred by its sale, the causes of action belonging to a prior holder do not pass with the transfer of the security. The provisions of the securities acts relied upon here create rights of action on the part of investors who have been harmed by the misconduct of others. Those rights belong to the *persons* who have suffered injury. They do not attach for all eternity to the security itself, to pass forever from the person who has been harmed to be asserted by others who have not. To adopt plaintiff's extraordinary theory would be to deprive injured persons of their rights and give their causes of action to one who has suffered no injury himself but who simply has been shrewd or lucky

enough to have put his hands on a security that once belonged to a person who was defrauded.

64 F.R.D. at 572.

Although not specifically referred to in *Saunders*, there is another factor which supports the contention that there can be no automatic assignment of § 10(b) claims. That is the language of §10(b) and rule 10b-5 themselves. Both prohibit the use of manipulative and deceptive devices "in connection with the purchase or sale of any security". See also *Blue Chip Stamps v. Drug Stores*, 421 U.S. 723 (1975). Any rule permitting the automatic assignment of such claims would have the effect of reading that language out of the statute and rule. This is so because a subsequent securityholder who purchases his security in an anonymous transaction on one of the national securities exchanges would be unable to prove that there was a purchase or sale of a security at the time of the fraud complained of since he could not possibly know when his transferor had purchased or sold his security. Only the transferor knows and is in a position to pursue his claim. Any other rule would render meaningless the "in connection with" language of Section 10(b).

There is yet a further reason the petitioners should not be found to have received an automatic assignment of their predecessors' claims. As noted in detail by Judge Garth these plaintiffs bought their Debentures with full knowledge of the dividend declaration and in doing so were speculating that they might be able to collect the dividend (10a-11a n.5).[12] Little wonder Judge Garth re-

12. Of course, since the plaintiffs were aware of the existence of such claims, there was nothing which prevented them from obtaining an express assignment of those claims.

fers to such persons as "corporate bounty hunters" (18a). To allow the securities laws to be used by such plaintiffs would only encourage the further speculation in lawsuits, ultimately to the detriment of all investors.

Petitioners, while acknowledging federal law controls, rely heavily upon New York state law in support for their position. Curiously enough, however, they fail to mention that under New York law, such speculation in lawsuits is specifically banned by N.Y. Jud. Law §489 (McKinneys 1968). Section 489 prohibits any purchase of a bond by a corporation such as the corporate plaintiff in this case with the intention of bringing suit on the bond.

CONCLUSION

Based upon the foregoing cases, authorities and arguments it is respectfully requested that the Court grant a writ of certiorari with respect to the issue of whether there has been a violation of Section 10(b) and Rule 10b-5 and that the Court deny the writ of certiorari as to the issues raised by the petitioners.

Respectfully submitted,

....

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SUPPLEMENTAL APPENDIX

IN THE
UNITED STATES DISTRICT COURT
FOR THE WESTERN DISTRICT OF PENNSYLVANIA

LUCILE LOWRY and LOWRY-ZWEIG CORP., Plaintiffs, v. THE BALTIMORE AND OHIO RAILROAD COMPANY, THE CHESAPEAKE & OHIO RAILROAD COMPANY AND CHESSIE System, Inc., Defendants.	Civil Action No. 79-1504-B

DEFENDANTS' MOTION FOR SUMMARY JUDGMENT

AND NOW come defendants, The Baltimore and Ohio Railroad Company ("B & O"), The Chesapeake and Ohio Railway Company ("C & O") and Chessie System, Inc. ("Chessie"), by and through their counsel, Richard T. Wentley, Anthony J. Basinski and Reed Smith Shaw & McClay and do hereby move this Honorable Court for an Order pursuant to Rule 56 of the Federal Rules of Civil Procedure granting all defendants summary judgment for the reason that there is no dispute as to any material fact and defendants are entitled to judgment as a matter of law and in support thereof do aver as follows:

1. Plaintiffs, Lucile Lowry and Lowry-Zweig Corp., brought a class action against defendants for violation of §10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 promulgated thereunder, a trust indenture and a listing agreement with the New York Stock Exchange.

2. Plaintiffs are alleged to be present and past holders of certain B & O convertible debentures (the "Debentures").

3. Plaintiffs complain that they or their predecessors in interest were improperly denied notice of the payment of a dividend by the B & O to its shareholders of certain stock of a wholly-owned subsidiary of the B & O, Mid-Allegheny Corp.

4. Plaintiffs' claims against defendants are identical to those alleged by the plaintiffs in *Pittsburgh Terminal Corp. v. The Baltimore and Ohio Railroad Company, et al.*, C. A. 77-1455 and *Monroe Guttmann v. The Baltimore and Ohio Railroad Company, et al.*, C. A. 79-94, which actions were tried before this Court on July 21-24, 1981.

5. On March 10, 1981, this Court issued its opinion and order in the *Pittsburgh Terminal* and *Guttmann* actions dismissing all of the plaintiffs' claims and directing that judgment be entered in favor of all of the defendants.

6. Judgment was so entered on March 11, 1981.

7. The Court's decision in those cases necessarily decided the very issues presented by the instant case.

8. This Court may take judicial and/or actual notice of its findings of fact and conclusions of law in those matters in the present case:

A. "Plaintiffs have failed to establish that the corporate defendants had the requisite scienter to establish a violation of Section 10(b) and 10b-5." (Conclusion of Law No. 2).

B. "The Indenture does not require that any notice be given debentureholders of a dividend payable on the stock of a company other than the B & O because such a dividend is the equivalent of a cash dividend although payable in kind." (Conclusion of Law No. 6).

C. "Plaintiffs have failed to prove that they have a right to proceed on an implied cause of action for any breach of any listing agreement with the New York Stock Exchange or the Rules of said Exchange." (Conclusion of Law No. 7).

9. Furthermore, the Court is required by the principles of *stare decisis* to follow its prior decision in the *Guttmann* and *Pittsburgh Terminal* matters.

WHEREFORE, defendants above named respectfully request that this Honorable Court enter an order granting summary judgment in their favor on all of plaintiffs' claims for the reason that there is no dispute as to any material fact and defendants are entitled to judgment as a matter of law.

Respectfully submitted,

....

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UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

No. 81-1976

LUCILE LOWRY and LOWRY-ZWEIG CORP.,
Appellants

vs.

THE BALTIMORE AND OHIO RAILROAD COMPANY,
THE CHESAPEAK & OHIO RAILROAD COMPANY AND CHESSIE SYSTEM INC.
(D.C. Civil No. 79-1504)

On Appeal From the United States District Court For the Western District of Pennsylvania

Present: SEITZ, *Chief Judge;* ALDISERT, ADAMS, GIBBONS, HUNTER, GARTH, SLOVITER and BECKER, *Circuit Judges.*

JUDGMENT

This cause came on to be heard on the record from the United States District Court for the Western District of Pennsylvania and was argued by counsel on December 16, 1981, and reargued before the Court in banc on November 8, 1982.

On consideration whereof, it is now here ordered and adjudged by this Court that the judgment of the said District Court, entered May 18, 1981, be, and the same is hereby affirmed insofar as it dismissed the federal claims of the appellants and vacated insofar as it dismissed the state law claims, and the cause remanded for proceedings consistent with the opinion of this Court. Each side to pay its own costs.

ATTEST:
SALLY MRVIS
Clerk

May 10, 1983

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May 11, 1981

Honorable William W. Knox
United States District Court
Western District of Pennsylvania
U.S. Post Office & Courthouse
Pittsburgh, PA 15219

Re: Lucile Lowry, et al. v. The Baltimore and Ohio Railroad Company, et al. Civil Action No. 79-1504-B

Dear Judge Knox:

This relates to Your Honor's scheduling order of May 5, fixing May 15 for movants' brief, May 25 for respondents' brief and June 15 for oral argument on defendants motion for summary judgment.

It is my understanding that Your Honor invited defendants' motion. The short moving papers present three grounds for judgment, concluding that "the Court is required by the principles of *stare decisis* to follow its prior decision in the *Guttmann* and *Pittsburgh Terminal* matters." Our response which was filed on May 5, is also concise, acknowledging, at page 3, that your rulings in the *Guttmann* cases are adverse precedents.

Granting of the motion seems a foregone conclusion. As I believe Your Honor knows, the *Guttmann* plaintiffs

are appealing your post-trial decision. In this posture it would seem to be appropriate that the apparently inevitable dismissal of the *Lowry* action occur sooner rather than later, so that the Third Circuit may hear and decide your dismissals of the *Lowry* and *Guttmann* cases on a consolidated basis at one and the same time.

In short, there seems to be no need for the briefing and oral argument which Your Honor has scheduled. The matter seems already ripe for decision. Accordingly, I respectfully request that you withdraw your scheduling order and decide the motion on the present papers.

Sincerely
ROBERT B. BLOCK
Robert B. Block

RBB:rrf
cc: Richard T. Wentley, Esq.
Michael P. Malakoff, Esq.

P.S. Please correct my name in your records to "Robert B. Block".

P.P.S. After conversation with counsel for the Baltimore & Ohio Railroad, they have authorized me to express their concurrence and joinder in the request for a decision of the Motion for Summary Judgment on the papers now before the Court.

IN THE
UNITED STATES DISTRICT COURT
FOR THE WESTERN DISTRICT OF PENNSYLVANIA

LUCILE LOWRY and LOWRY-ZWEIG CORP., Plaintiffs, -against- THE BALTIMORE AND OHIO RAILROAD COMPANY, THE CHESAPEAKE & OHIO RAILROAD COMPANY AND CHESSIE System, Inc., Defendants.	No. 79-1504-B

NOTICE OF APPEAL

Notice is hereby given that Plaintiffs, Lucile Lowry and Lowry-Zweig Corp,, appeal to the United States Court of Appeals for the Third Circuit from (a) the final and judgment dated May 15, 1981 granting the motion for summary judgment of Defendants, The Baltimore and Ohio Railroad Company, The Chesapeake & Ohio Railroad Company and Chessie System, Inc., and dismissing the action; and (b) from the orders dated April 7, 1980 and May 5, 1980 insofar as they narrow the class as defined in the complaint.

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